

**SECTION 530: ITS HISTORY AND APPLICATION IN
LIGHT OF THE FEDERAL DEFINITION OF THE
EMPLOYER-EMPLOYEE RELATIONSHIP FOR
FEDERAL TAX PURPOSES**

National Association of Tax Reporting and Professional Management

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I. INTRODUCTION

A. Purpose of Paper.

The purpose of this paper is to provide pertinent decision makers a concise history of Section 530 of the Revenue Act of 1978 (Section 530) and the development of employer-employee relationship as defined for federal tax purposes to allow for a better understanding of current and proposed policies with respect to worker classification issues. It also raises concerns about current administration of Section 530 and proposes possible solutions.

B. National Association of Tax Reporting and Professional Management.

The National Association of Tax Reporting and Professional Management (NATRPM) is a non-profit corporation organized to address the tax reporting and payroll industries' international, federal, state and local legislative and regulatory issues, technical tax issues, technology developments, and operational issues. Its members include accountants, attorneys and others that provide employers advice and counsel regarding compliance with federal, state and local payroll and tax reporting issues.

C. Organization of this Paper.

In addition to this Introduction, Section II explains the history of the development of "the usual common law rules" used to determine whether a worker is an employee or independent contractor and provides a short primer on the meaning of the phrase. Section III provides the history of Section 530, its purpose and how it operates. Section IV describes the IRS' administration of worker classification cases in light of Section 530, with particular emphasis on changes since 1996. Section V discusses current legislative proposals to change Section 530. Section VI sets forth concerns about how Section 530 is being applied by the IRS. Section VII proposes some suggestions for improving Section 530 compliance.

II. HISTORY OF THE EMPLOYER-EMPLOYEE RELATIONSHIP FOR FEDERAL TAX PURPOSES

One of the most confusing and difficult concepts to understand in federal tax law is the dividing line between employees and independent contractors. Nonetheless this distinction is critical for numerous reasons, including, but not limited to, whether a person paying a worker is liable for withholding and remitting federal Income, Social Security, and Medicare taxes from the worker's pay, how certain fringe benefits should be taxed, and the right to deduct certain kinds of expenses.

With certain exceptions, the determination of the employer-employee relationship is based on "the usual common law rules."¹ This seemingly innocent sounding definition, however, has a long history that is pertinent to issues today.

A. History of common law rules for worker classification for federal tax purposes.

As originally enacted, the Social Security Act did not contain an express definition of an "employee." Shortly after enactment of the Social Security Act the United States Treasury Department enacted regulations that adopted the common law control test to determine whether a worker was an employee or an independent contractor for federal employment tax purposes.²

Despite the Treasury Regulation, the federal courts used conflicting tests to determine a worker's status for employment tax purposes. These conflicting tests culminated in 1947 in two United States Supreme Court opinions: *United States v. Silk*³ and *Bartels v. Birmingham*.⁴

In *Silk* and *Bartels* the Supreme Court held that while control was an important factor to consider, it was not the only one. Rather, the worker's status should be considered in light of the purpose of the social security legislation and "employees included those who as a matter of economic reality were dependent upon the business to which they rendered services."⁵

As a result of *Silk* and *Bartels*, the United States Treasury Department promulgated new regulations in 1947 "defining the employer-employee relationship on the basis of the economic reality test. The proposed regulation caused considerable criticism in Congress and lead to enactment in June 1948 of H.J.Res. 296 (62 Stat. 438)

¹ E.g., IRC, § 3121(d)(2) ("(d) For purposes of this chapter, the term 'employee' means - ... (2) any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee ...").

² See 1 F.D. 1764 (1936) (reproduced and discussed in *United States v. Silk*, 331 U.S. 704, 714 n. 8 (1947)); see also *Illinois Tri-Seal Products, Inc. v. United States*, 353 F.2d 216, 224 (1965).

³ *United States v. Silk*, 331 U.S. 704 (1947).

⁴ *Bartels v. Birmingham*, 332 U.S. 126 (1947).

⁵ *Illinois Tri-Seal Products*, 353 F.2d at 225 (discussing history of the conflicting tests used by federal courts that culminated in the *Silk* and *Bartels* opinions).

over President Truman's veto."⁶ The "Gearhart Resolution" was intended to "maintain the status quo in respect of certain employment taxes" by including a definition of "employee" in the Internal Revenue Code as follows: "'employee' does not include (1) any individual who, under the usual common-law rules applicable in determining the employer-employee relationship, has the status of an independent contractor or (2) any individual (except an officer of a corporation) who is not an employee under such common-law rules."⁷ Further,

[t]he legislative history of the Gearhart resolution makes clear that the Congressional intent underlying its passage was principally to override the economic reality test proposed by the Treasury Department and to require that the usual common-law rules realistically applied be used to determine whether a person is an "employee" for purposes of applying the Social Security Act. [Citations omitted.] Thus, the Senate Finance Committee Report on the resolution commented: that *the usual common-law rules were well stated in the existing Treasury Regulations* (as contrasted with the proposed regulation) and that the existing regulations might be considered a valid extension of Congressional intent; that the 'economic reality' concept was basic to the proposed regulation and that the proposed regulation would, therefore, discard the common-law rules for a new rules of 'nebulous' and 'dimensionless' character; that the proposed regulation would bring within the coverage of the [Social Security] Act many persons (including subcontractors) whose activities were largely or wholly free from direction as to how, and in frequent cases, as to when or whether they pursued them by this resolution we propose to restore the usual common-law rules, realistically applied.⁸

The changes were made retroactive to the date of the original enactment. "Congress thus rebuked the overzeal of the courts in trying to make a better law than the words of Congress has made."⁹

In 1950 amendments to the Social Security Act again reiterated that the proper test to determine worker status was the usual common law rules realistically applied.¹⁰ "The conclusion to be drawn from the foregoing is that the existence or absence of an employment relationship is to be ascertained not by use of the economic reality test but by applying the common-law rules realistically."¹¹

Thus, tracing the history of the phrase "the usual common law rules applicable in determining the employer-employee relationship" reveals that Congress enacted the phrase as an express rejection of the economic reality test. Further, the phrase was a reaffirmation of the common-law control test as it was well known and had been applied since 1935. It has been used for all federal tax purposes, including income tax

⁶ *Id.*

⁷ *Id.*, at 225-226; see also *United States v. Webb, Inc.*, 397 U.S. 179, 183-184 (1970) (tracing history of enactment of definition of "employee" for federal unemployment insurance tax purposes).

⁸ *Id.*, at 226-227 (emphasis added).

⁹ *New Deal Cab Co. v. Fahs*, 174 F.2d 318, 319 (5th Cir. 1949).

¹⁰ *Illinois Tri-Seal Products, Inc.*, 353 F.2d at 228.

¹¹ *Id.*

withholding, FICA and FUTA.

In 1992 the United States Supreme Court again unequivocally rejected the contention that the economic reality test used under the FLSA should apply for other purposes, including federal tax purposes, and again reiterated that the proper test is the common law test.¹²

For other federal laws, such as the Fair Labor Standards Act (FLSA), the definition of an employee differs from the usual common law rules. For example, many federal courts use the economic reality test of a hybrid test for purposes of the FLSA.¹³ Nonetheless, at least since 1948, the federal courts recognized the distinction between an employee for federal tax purposes and for other federal legislative purposes. For example, in *In re Miller*,¹⁴ a case dealing with whether or not a worker was an employee or self-employed for federal employment tax purposes, the court observed that “a separate line of decisions has attempted to define the term ‘employee’ in the context of the Fair Labor Standards Act. . . . that six-part test cannot be borrowed *in toto* for [federal employment tax] purposes. Congress and the courts have both recognized that, of all the acts of social legislation, the [FLSA] has the broadest definition of ‘employee’.”¹⁵

B. Meaning of “the usual common law rules.”¹⁶

The usual common law rules state that if an employer has the right to control both the ends as well as the means by which the worker performs his or her services, the worker is an employee.¹⁷ The existence of the employer’s right to control is critical; the exercise of that control is not. Thus, the Treasury Regulations state that “it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so.”¹⁸

In contrast, “if an individual is subject to the control or direction of another merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result, he is an independent contractor.”¹⁹ Each case must be determined by its own facts and circumstances.

In 1987 the IRS issued Revenue Ruling 87-41 in which the IRS distilled years of case law into a more manageable 20 factor test. While these 20 factors are commonly relied upon, it is not an exhaustive list and other factors may be relevant. Further, some

¹² *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318 (1992) (common law test for worker status used for ERISA purposes).

¹³ E.g., *Real v. Driscoll Strawberry Assocs., Inc.*, 603 F.2d 748, 754-755 (9th Cir. 1979) (adopting economic realities test for FLSA purposes).

¹⁴ *In re Miller*, 86 B.R. 817 (Bankr. E.D. Pa. 1988).

¹⁵ *Id.*, at 820 n. 1 (italics in the original) (internal quotations and citations omitted).

¹⁶ This is not intended to be an exhaustive discussion of how to determine whether a worker is an employee or an independent contractor, but merely provides context to the bigger issues discussed in this paper.

¹⁷ Treas. Reg. § 31.3121(d)-(1)(c).

¹⁸ Treas. Reg. § 31.3121(d)-(1)(c)(2).

¹⁹ *Id.*

factors may be given more weight than others in a particular case.²⁰ Further, in 1996 the IRS reorganized the twenty factors into three broad categories in its training materials:

(1) Behavioral Control: The facts which illustrate whether there is a right to direct or control how the worker performs the specific task for which he or she is engaged (*e.g.*, instructions, training *etc.*)

(2) Financial Control: The facts which illustrate whether there is a right to direct or control how the business aspects of the worker's activities are conducted (*e.g.*, significant investment, unreimbursed expenses, method of payment, opportunity for profit or loss, *etc.*)

(3) Relationship of the Parties: The facts that illustrate how the parties perceive their relationship (*e.g.*, intent of the parties/written contracts, employee benefits, discharge/termination, regular business activity, *etc.*)²¹

²⁰ IRS, "Independent Contractor or Employer? Training Materials," Training 3320-102 (October 30, 1996) ("IRS Training Guidelines"), at 2-4.

²¹ *Id.*, at 2-7.

III. SECTION 530 OF THE REVENUE ACT OF 1978

A. Background prior to enactment and leading up to its enactment.

Section 530 of the Revenue Act of 1978 was enacted in response to complaints by taxpayers that the IRS was too aggressive with respect to worker classification issues. It was originally intended as a temporary measure, but was made permanent by the Tax Equity and Fiscal Responsibility Act of 1982. It has since been amended by section 1706 of the Tax Reform Act of 1986 and section 1122 of the Small Business Job Protection Act of 1996.

B. Section 530 relief.

Section 530 is a safe harbor provision that prevents the IRS from retroactively reclassifying “independent contractors” as employees and subjecting the principal to federal employment taxes, penalties and interest for such misclassification. In order for an employer to qualify for section 530 relief, it must have:

- (1) Consistently treated the workers (and similarly situated workers) as independent contractors;
- (2) Complied with the Form 1099 reporting requirements with respect to the compensation paid the workers for the tax years at issue; and
- (3) Had a reasonable basis for treating the workers as independent contractors.

Section 530 does not make or validate workers as independent contractors but rather classifies them as “non-employees” for federal employment tax purposes. Section 530 also does not apply for purposes of federal classifications.

1. Substantially similar requirement.

To qualify for section 530 relief the employer must have consistently treated the workers and those in substantially similar positions as independent contractors. A substantially similar position exists if the job functions, duties and responsibilities are substantially similar and the control and supervision of those duties and responsibilities are substantially similar.²² This requires consideration of the relationship between the taxpayer and those individuals.²³

The substantially similar treatment requirement only applies to federal tax treatment. Thus, if a business treats workers as employees for state unemployment tax or wage and hour law requirements, such treatment for state purposes will not make section 530 inapplicable.²⁴ Of course, this also does not make the worker an independent contractor; rather, it merely exempts the employer from the employment tax obligation.

²² IRS Training Guidelines, at 1-9.

²³ Section 530(e)(6).

²⁴ IRS Training Guidelines, at 1-11.

In addition, the worker's status as an employee for other federal purposes is not resolved by Section 530.

2. Employer must file all required returns for the tax year at issue.

The consistency requirement provides that a business must have timely filed Form 1099 with respect to the worker for the tax period at issue. Failure to timely file in a tax period will not prevent section 530 relief in periods where returns were timely filed. Further, if there is no obligation to file a Form 1099, section 530 relief will not be denied because no return was filed. A business that files the wrong kind of Form 1099 in good faith does not lose eligibility for section 530.²⁵

While the IRS has taken the position that the 1099s must be timely filed before Section 530 relief is available, this position has been rejected by the courts. For example, in *Medical Emergency Care Associates v. Commissioner*²⁶ the Tax Court rejected the IRS's contention that 1099s must be timely filed, finding no such requirement under the plain language of the statute. It also rejected the IRS's argument that its interpretation as contained in Revenue Procedure 85-18 was entitled to deference. The IRS takes the position that filing the wrong 1099 in good faith will not prevent section 530 relief.

3. Reasonable basis requirement broadly applied.

There is no explicit definition of what constitutes a "reasonable basis" for purposes of section 530. Nonetheless, it is to be liberally construed in favor of the taxpayer.²⁷ There are four categories of authority that may be relied upon as a reasonable basis: (1) federal judicial precedents and administrative rulings; (2) a prior audit of the taxpayer; (3) industry custom; and (4) a catch-all "other" reasonable bases.

a. Judicial decisions and administrative rulings.

Taxpayers may rely upon any federal judicial precedent or published revenue ruling. However, state court opinions or state administrative agency rulings do not qualify under this safe haven provision as a reasonable basis for section 530 relief.²⁸ In addition, because reliance must be reasonable, the taxpayer must be able to demonstrate a reasonable similarity to the case and its situation. However, this does not mean that the facts must be identical or involve the same industry.²⁹

In addition, an employer may rely upon a technical advice memorandum or private letter ruling, but only if it was issued to the employer. Private letter rulings issued

²⁵ Rev. Rul. 81-224, 1981-1 C.B. 197.

²⁶ *Medical Emergency Care Associates v. Commissioner*, 120 T.C. 436 (2003).

²⁷ H.R. Rep. No. 1748, 95th Cong 2nd Sess. 4 (1978), 1978-3 C.B. (Vol. 1) 629, 633 ("The committee intends that this reasonable basis requirement be construed liberally in favor of taxpayers"); see also Rev. Proc. 85-18, 1985-1 C.B. 518.

²⁸ IRS Training Guidelines, at 1-24.

²⁹ *Id.*

to other employers are not likely to meet the reasonable basis requirement.³⁰

b. Prior audits of the taxpayer.

A taxpayer may also rely upon a prior audit if it meets certain requirements. The 1996 Act requires that when the IRS audits a taxpayer and identifies a possible worker-classification issue, it must provide the taxpayer with a written notice that explains section 530. Thus, for audits that commenced after December 31, 1996, the audit must have specifically dealt with the classification of the workers at issue, or workers similarly situated, for employment tax purposes, in order for the audit to be a reasonable basis for section 530 relief. However, for audits that commenced prior to January 1, 1997, the audit is not required to have specifically addressed the worker classification issue.³¹

c. Industry custom or practice.

Employers may also rely upon industry custom or practice, if such custom or practice is a long-standing custom or practice of a significant segment of the industry. What constitutes an industry can be subject to debate, but generally consists of businesses in the same geographic area that compete for the same customers.

Whether a practice is long-standing depends upon the facts and circumstances, but section 530 states that a practice in existence at least 10 years should always be long-standing.³² It is irrelevant when the practice came into existence, so long as it has existed for 10 years.³³

A significant segment of the industry is defined in section 530 as 25 percent of the taxpayer's industry, without including the taxpayer.³⁴ Case law and legislative history suggest that a lower percentage may qualify as significant depending upon the facts and circumstances.³⁵

d. Other reasonable bases.

If none of the three safe havens above apply, a fourth catch-all safe haven may apply. Under this provision any "other" reasonable basis may be grounds for section 530 relief. These grounds have included reliance upon advice from an accountant or attorney, but only if such advice was relied upon when treatment of workers as independent contractors began.³⁶ The cases have generally required that the business demonstrate that the attorney or accountant had relevant education or experience to render such advice,

³⁰ *Darrell Harris, Inc. v. United States*, 770 F. Supp. 1492 (W.D. Okla. 1991).

³¹ Section 530(e)(2).

³² Section 530(e)(2)(C)(i).

³³ Section 530(e)(2)(C)(ii).

³⁴ Section 530(e)(2)(B).

³⁵ IRS Training Guidelines, at 1-28.

³⁶ *In re Compass Marine Corp.*, 146 B.R. 138 (Bankr. E.D. Pa. 1992) (advice issued three years after the treatment does not constitute reasonable basis for treatment).

and did so only after review of all relevant facts furnished by the business.³⁷

The common law rules have also been accepted as a reasonable basis for treatment where they were applied in good faith but fell short of satisfying the common law standard.³⁸

Further, prior state administrative decisions or other federal determinations (*e.g.*, determination under Federal Labor Standards Act) may be a reasonable basis. For example, a district court held that an employer's treatment of dentists as independent contractors based on the State Dental Board's conclusion that state law prohibited a licensed dentist from being an employee of an unlicensed business corporation was a sufficient reasonable basis for section 530 relief.³⁹

³⁷ *In re McAtee*, 115 B.R. 180 (Bankr. N.D. Iowa 1990), *Overeen*, 91-2 U.S. Tax Cas. (CCH) P50,459 (WD Okla. 1991).

³⁸ *In re Critical Care Registered Nursing, Inc.*, 138 B.R. 378 (Bankr. E.D. N.Y. 1992); *American Institute of Family Relations v. United States*, 79-1 U.S. Tax Cas. (CCH) P9364 (C.D. Cal. 1979).

³⁹ *Queensgate Dental Family Practice, Inc. v. United States*, 91-2 USTC No. 50,536 (MD PA - 1991); but see *Spicer Accounting, Inc. v. United States*, 918 F.2d 90 (9th Cir. 1990) (state's determination of worker status for state employment tax purposes did not preclude federal government from challenging status when federal government was not party to proceeding or in privity with the state).

IV. CHANGES IN IRS ADMINISTRATION OF THE WORKER CLASSIFICATION ISSUE

While the worker classification issue has not gone away, for most businesses it has been on the “back burner” for over a decade. In 1996, recognizing that the relevance of the common law factors varies depending on the nature of the business and may change over the years as the business environment changes, and after seeking input from the public, the IRS revised the training for its revenue agents. The stated goal of the IRS Training Guidelines was “to ensure that IRS examiners properly classify workers as independent contractors or employees in a manner that is impartial and reflective of current law.” Examiners were encouraged to consider the entire relationship between a business and a service provider and to understand that as long as the rules were followed, businesses could legitimately use independent contractors. Additionally examiners were reminded that it was congressional intent that certain relief provisions of Section 530 be construed liberally in favor of taxpayers.

During the same time period the IRS launched the Classification Settlement Program (CSP). The CSP provides a standard settlement agreement for instances in which the examiners determine that certain workers are misclassified.⁴⁰ The settlement offer, which is still in place, is quite favorable. In most cases, if a business agrees to begin treating the workers in question as employees prospectively, a tax assessment is made for only one year (rather than for all years of the examination). Moreover, the tax rate used for this assessment, assuming the misclassification was not a matter of intentional disregard, is a rate that is much less than the usual federal income tax withholding and FICA rates.⁴¹ The program was developed around Section 530 and the amount of relief provided under the CSP depends on the strength of the business’ Section 530 argument.

It is a good guess that this effort helped the IRS with its backlog of highly contentious worker classification cases. With the IRS’ very public effort to increase taxpayers’ confidence that examiners were unbiased in their determinations and ease the administration of the issue, many businesses enjoyed a “quiet period” because the practical result was that agents seemed to lose interest in the status issue. Likewise for businesses, there was very little motivation to make any self-corrections. The “deal” was better if the IRS found the error and made a CSP assessment as a result of an examination.

For several possible reasons, including but not limited to the perceived growing tax gap for employment taxes, there appears to be a renewed focus on worker classification issues. The IRS is not alone in its pursuit of misclassified workers, and in fact may be reacting to some encouragement from Congress. Senate appropriators voted July 12, 2007, to urge the IRS to provide increased enforcement in industries where the misclassification of employees as independent contractors is widespread.

⁴⁰ See IRS Fact Sheet FS-96-05.

⁴¹ IRC, § 3509.

John Tuzynski, IRS Chief of Employment Tax, told the American Bar Association Section of Taxation meeting that worker classification cases will be a major focus in 2008. Since that time the IRS has announced that it entered into memorandums of understanding with nearly 30 states to share data and collaboratively approach this and other employment tax issues,⁴² hosted a web cast to discuss the importance of properly classifying workers, and published new Form 8919, *Uncollected Social Security and Medicare Tax on Wages*.

Form 8919 is to be used by workers who believe they have been misclassified as independent contractors and allows them to calculate and report the employee's share of uncollected social security and Medicare taxes due on their compensation. A requirement for filing Form 8919 is that the worker must file a request for an SS-8 Determination, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*. The IRS has informally stated that the number of SS-8 requests has nearly doubled since the introduction of Form 8919.

⁴² IR-2007-184.

V. LEGISLATIVE INITIATIVES TO CHANGE SECTION 530 OR OTHERWISE IMPACT WORKER CLASSIFICATION ISSUES AT THE FEDERAL LEVEL

In the 110th Congress (2007-2008), two bills were introduced that, if enacted, would have amended or terminated Section 530 and created other requirements relating to worker classification. A separate bill was introduced to amend the Fair Labor Standards Act with regard to worker classification.

A. S. 2044, “Independent Contractor Proper Classification Act of 2007”.

S. 2044 was introduced in September 2007 by Senator Barack Obama, and was co-sponsored by Senators Barbara Boxer, Hillary Rodham Clinton, Richard Durbin, Edward M Kennedy, Barbara Ann Mikulski, and Patty Murray.

Section 2 of S. 2044 included the following provisions which would have amended Section 530 of the Revenue Act of 1978 as amended:

- (a) Allow prospective reclassifications;
- (b) Eliminate the ban on the IRS issuing regulations or revenue rulings on employee/independent contractor status; and
- (c) Eliminate the ability of employers to rely on industry practice as a basis for claiming the safe harbor.

Section 3 of S. 2044 would have amended Section 530 to create new administrative procedures for the review of worker status by allowing any individual who performs services for a taxpayer entity to petition the Secretary of the Treasury (either personally or through a designated representative or attorney) for a determination of the individual’s status for employment tax purposes, to receive a determination of status within 90 days after filing of the petition, allow for an administrative appeal of the determination, award expenses against the taxpayer entity in any case in which the individual achieves reclassification and allow for an assessment of such expenses against the taxpayer entity.

Taxpayer entities would be specifically prohibited from retaliation against an individual because the individual filed a petition for a reclassification determination. In addition, the Secretary of the Treasury must also inform the Department of Labor in any case in which a misclassification was found, notify the individual of any eligibility for the refund of self-employment taxes; direct the taxpayer entity to take affirmative action to abate the violation, and “if necessary” perform an employment tax audit.

Section 4 of S. 2044 would have required the Secretary of the Treasury and Secretary of Labor to each issue annual reports on worker misclassification, including the number of type of enforcement actions and audits, relief obtained as a result of actions against employers, estimate of the number of employers misclassifying workers and

which industries are involved, impact of misclassification on the Federal tax system, and number of worker misclassification cases for which each Secretary has provided information to the other and the outcomes of the complaints. The Secretary of Labor would also be directed to identify and track complaints and enforcement actions of worker misclassification by the Wage and Hour Division, and conduct investigations of industries in which worker misclassification is present.

Section 5 of S. 2044 would require notices of the right to petition for a reclassification determination (and other related information) to be posted in the workplace, and furnished to independent contractors when they contract to provide services. A recordkeeping requirement would be created for employers, to maintain records of independent contractor information specifically for worker classification purposes.

S. 2044 was referred to the Senate Committee on Finance and did not reach the floor of the Senate.

B. H.R. 5804, “Taxpayer Responsibility, Accountability, and Consistency Act of 2008”.

H.R. 5804 was introduced in April, 2008, by Representative Jim McDermott, and had 37 co-sponsors.

Section 3 of H.R. 5804 would have terminated the use of Section 530 and replaced it with a different set of rules, designated as IRC section 3511. It stated that if, for purposes of employment taxes, the taxpayer did not treat an individual as an employee for any period, and all Federal tax returns (including information returns) required to be filed with respect to such individual for the period were consistent with non-employee status, then the individual shall be deemed not an employee unless the taxpayer (for which services were performed) “had no reasonable basis for not treating such individual as an employee.”

Section 3 created a new statutory standard for this “reasonable basis” for deeming a worker to be a non-employee. This standard would require reasonable reliance on:

(1) An IRS written determination issued to the taxpayer addressing the employment status of that individual or another individual holding a substantially similar position with that taxpayer, or

(2) A concluded IRS examination for employment tax purposes, with respect to which there was no determination that the individual, or another individual holding a substantially similar position with that taxpayer, should be treated as an employee.

H.R. 5804 also included provisions already described as included in S. 2044, such as information sharing between the Secretary of the Treasury and Department of Labor, the issuance of annual reports, and the ability of individuals to petition the Secretary of Treasury for a determination as to status.

H.R. 5804 was referred to the House Committee on Ways and Means and did not reach the floor of the House.

As of the date of this paper, neither these nor similar bills have been introduced in the 111th Congress.

C. S. 3648, “Employee Misclassification Prevention Act”.

S. 3648 was introduced in the Senate in September, 2008, by Senator Harry Reid on behalf of Senator Edward M. Kennedy, co-sponsored by Senators Barack Obama and John Kerry. The same legislation was introduced in the House as H.R. 6111. These bills addressed worker misclassification issues through amendments to the Fair Labor Standards Act to require employers to keep special records of non-employees who perform labor or services for remuneration; require notices to workers informing them of rights and consequences of employee versus non-employee status; requiring a Department of Labor web page on employee rights; and providing special penalties of \$10,000 per violation and doubled liquidated damages for employers who misclassify employees as non-employees.

S. 3648 was referred to the Senate Committee on Health, Education, Labor and Pensions. H.R. 6111 was referred to the House Subcommittee on Income Security and Family Support. Neither bill moved out of committee.

VI. CURRENT PROBLEMS WITH THE APPLICATION OF SECTION 530

NATRPM has found that although agents are following the rules, application of Section 530 Relief is difficult and fact-intensive and agents may not always be clear on how to apply it to a given set of facts. Practitioners and employers also find the Section 530 Relief process to be difficult, and are therefore concerned that the evaluation of whether the facts satisfy the section 530 requirements may not always proceed as it should. It was also not clear in our query results that IRS Publication 1976, *Do you Qualify for Relief under Section 530*, was always being provided to employers at the early stage of the audit whenever the agent knew that the misclassification issue could arise. What is clear at this point is that the Section 530 Relief process is complicated and it is therefore important for the IRS to inform employers about its possible application as soon as possible in an audit.

Section 530 remains the law. Further, the need for Section 530 has not diminished over the last 30 years, as there is no less confusion or difficulty in determining a workers status than there was in 1978. In fact, if anything, the determination has become even harder because of the IRS' inability to provide guidance on worker classification issues. Thus, compliance with Section 530 is even more important today than it has ever been.

VII. POSSIBLE SOLUTIONS TO THE CURRENT CONCERNS

NATRPM proposes that IRS provide IRS agents reminders of the following four requirements of the current IRS policy and existing law:

- (1) Section 530 should be considered as the first step in any case involving worker classification;
- (2) It is the IRS' position that the agent must explore the applicability of 530 even if the business does not raise the issue;
- (3) The agent is required to provide IRS Publication 1976, *Do You Qualify for Relief Under Section 530*, at the beginning of the employment tax exam; and
- (4) The legislative history of the statute makes it clear that Congress intended that "reasonable basis" be liberally interpreted in favor of taxpayers.

NATRPM believes that such reminders could take the form of a Field Director's Guidance and/or refreshed training.

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